Commission of Inquiry
into
Residential Tenancies

The Costs of Rent Review in Ontario

Enid Slack

Research Study No. 26

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THE COSTS OF RENT REVIEW IN ONTARIO

by

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The Costs of Rent Review

Chapter 1: INTRODUCTION

The costs of rent review have been said to be both very large and very small depending on what one includes in the estimates of cost. In terms of direct government expenditures, the costs are considered to be small compared to direct subsidy programs such as shelter allowances. In terms of the costs of foregone income to landlords, search costs for tenants, and foregone tax revenues to government, the costs are considered to be large. Some costs are measurable; others are not.

The purpose of this study is two-fold: first, it is to review all of the costs of rent regulation to the various parties - landlords, tenants, government and others in the economy. Second, it is to compare the costs of rent review to the costs of two other major (actual or potential) housing programs - shelter allowances and public housing. This paper relies heavily on other work done for the Commission as well as the broader literature on rent regulation. It is intended to bring together the analysis from these different sources and summarize the results.

The identification of costs associated with each program is intended to be comprehensive, although, in many cases, the actual estimates may be difficult to obtain. At the very least, a discussion of what information would have to be collected to determine costs is provided. One important distinction will be drawn throughout the study and that is the differentiation between economic costs and transfers. Economic costs (of greatest significance to economists though not necessarily to landlords,

tenants or politicians) are those costs which use up resources that would have otherwise been available to use elsewhere in the economy (possibly more productively though it is not guaranteed); transfers involve some form of redistribution from one group in society to another. Although very important to the various groups involved in housing programs, these costs do not generally represent a loss of output to society but rather a redistribution of resources.

In looking at the costs of rent review, one major problem re-emerges - the isolation of the impact of rent review. To determine the costs of rent review it is necessary to know its effect on such variables as rents, the number of rental housing starts, the level of maintenance expenditures and so forth. For example, the data show that, since rent review was introduced in Ontario in 1976, rental starts have fallen significantly but this does not mean that rent review was entirely responsible for the reduction. Other factors may have contributed to the decline in rental starts: for example, high interest rates, escalating land costs and demographic changes. The point is that it is very difficult to determine how much of the decline in rental starts can be attributed to rent review and how much would have occurred in any event.

This type of problem arises over and over again in the analysis of the costs of rent review (and of the other programs). Consequently, the estimates that are given in this study are based on a number of underlying assumptions, some of which are more certain than others. Most of the numbers that are provided are based on previous estimates developed by other authors for Ontario. Since there are often discrepancies in these

numbers, a range of estimates is provided, where possible. Caution should be exercised in trying to interpret these estimates since they have not relied, in many instances on detailed analysis.

A comparison of the costs of rent review and the costs of shelter allowances and public housing presents two additional problems. First, the literature is more comprehensive in terms of the number and types of costs identified for rent review than it is for other housing programs. For example, the literature on the costs of housing programs usually considers subsidy costs and administrative costs. The studies of the costs for rent review include redistributive and administrative costs but also go on to look at efficiency costs, compliance costs, lobbying costs, search costs and more. Presumably this discrepancy results because of the relatively greater number of opponents to rent review or because shelter allowances are not as widespread as rent review. In any event, the present study will attempt to consider a comprehensive list of costs for all three programs. This of course means, however, that some of the costs of shelter allowances and public housing have not been previously quantified (or even considered).

Second, comparability of costs is particularly difficult because the benefits and the distribution of benefits of each program are different. Some authors (see, for example, Slack and Amborski (1984) and Stanbury (1984)) have argued that rent review provides benefits for middle-income groups. At the very least, it can be noted that low-income households in public housing are exempt from the benefits of rent review. A program like shelter allowances, on the other hand, is specifically targetted to low-income people (the elderly, families and in some cases all low-income

households). A $1 expenditure for rent review and a $1 expenditure for a shelter allowance provide different benefits, making comparisons difficult. When reviewing costs, it should be kept in mind that the distribution of benefits of each program is likely to be different. And, as noted above, comparing costs does not mean that one policy can be chosen over another policy since the objectives of each are different. Plus, a combination of policies may be required to achieve an overall set of housing policy objectives.

The remainder of this paper is divided into three broad sections - the costs of rent regulation, the costs of shelter allowances, and the costs of public housing. Each of these sections is sub-divided into economic costs (or efficiency costs), transfers (or redistributive costs) and other costs to government (some of these are economic costs and some are transfers). In the case of shelter allowances and public housing, a section is added on the comparability of costs with the costs of rent review. A final section provides a summary and some conclusions.

Chapter 2: COSTS OF RENT REGULATION

1.0 ECONOMIC COSTS

Discussion of the economic (or efficiency) costs of rent review are provided in Stanbury and Vertinsky (1985) and in Hartle (1984). This section briefly reviews what efficiency means and what are the components of economic costs.

The economy is said to be efficient if no reallocation of resources can make one person better off without making another person worse off. Another way to define efficiency is to say that, given society's limited resources, the maximum output attainable is being produced. An efficient allocation of resources would result from a perfectly competitive market in which there is no government intervention, where there are no transaction costs, where households and firms have perfect information and where the actions of any individual cannot affect the price in the marketplace.

Recent literature questions whether the rental housing market would be competitive in the absence of rent regulation. The existence of zoning and other land use controls, and imperfect information, for example, suggest that the market may be imperfectly competitive. In this paper, efficiency costs of rent regulation are compared to a market without rent regulation (whether or not such a market is perfectly competitive).[1]

[1]For a discussion of the impact of rent regulation on efficiency where it is assumed that the rental market is not perfectly competitive, see Slack and Amborski (1984), pp. 20-26.

In terms of economic costs, this section looks at effects on the demand side, the supply side, on information, search and transaction costs, on rent-seeking activities and on direct administrative costs. In all of these cases, resources are being used up (because of rent regulation), resources that could have been used elsewhere in the economy. In other words, these are economic costs.

1.1 Effects on Demand

Sitting tenants, those in rent regulated units, benefit from the introduction of rent regulation because the rents they pay are lower than they would have been in the absence of regulation. However, a distortion in economic behaviour results because they are now induced to stay in the rent regulated unit even if that accommodation is no longer appropriate (for example, because family circumstances or location of work have changed). A counter-argument is that certain aspects of the market may force rents to go above the perfectly competitive rent level, causing people to move. These would be inefficient moves. One could argue in this scenario that rent regulation is reducing inefficient moves. This debate is beyond the scope of this paper, however.

In a dual market, renters in unregulated units are said to face higher rents than they would in an unregulated market. Those in regulated units benefit from regulation but their benefit could be greater (and the distortion or inefficiency smaller) if they received their benefits in cash rather than through the regulation of rents. With a cash benefit, they would be free to choose the mix of goods and services that they most desired, that is, how much housing versus how much food and what type of

housing. The important factor is that the benefit of rent review is tied to the controlled unit. Since the benefit cannot be used for ownership housing or uncontrolled units, it is thus a tied benefit. This aspect limits the freedom of choice of the renter.[2]

It is difficult to measure this inefficiency which represents the loss of consumer utility from rent regulation. One can perhaps look, however, at the impact of rent regulation on the mobility of tenants to get an idea of the behavioural response to rent regulation.

The Ministry of Municipal Affairs and Housing, MOMAH (1982) analyzed mobility or the percentage of renters who have moved during the previous twelve months. Their survey for Metropolitan Toronto, for example, showed that mobility rates (or annual turnover) declined since rent review was introduced. The annual turnover rate was 41 percent in 1976-77 compared to 29 percent in 1980-81 and 1982-83. As Stanbury and Vertinsky (1985) note, however, this discrepancy does not only reflect the advent of rent review. Other reasons for the decline in mobility rates include: vacancy rates, the relative size of the controlled and uncontrolled sectors, landlord and tenant legislation, the age structure of the population, the composition of households, the ease of moving into the ownership market and the size of the rent gap in the controlled and uncontrolled markets.[3] Also, as noted

[2]One caveat applies here. Since choice involves moving to the most desired (or most appropriate) unit, it is not clear whether a cash transfer will always be preferred. In other words, there are benefits to being in appropriate accommodation but there are also costs of moving (to get there).

[3]Of course some of these factors may also be indirectly attributed to rent review: vacancy rates, the relative size of the controlled and uncontrolled sectors, and the rent gap in the controlled and uncontrolled markets.

above, the reduced mobility may represent a gain in efficiency as undesired moves resulting from fluctuations in rents are eliminated.

This particular efficiency cost is an economic cost but it is hard to measure. How does one put a dollar figure on how much happier consumers of rental housing would have been with cash instead of a rent-regulated unit? The essence of this argument, however, is that the benefits of rent regulation may be somewhat less than the measure of reduced rents would indicate, but no one has determined how much less. In terms of mobility, it is possible that people are not living in the units they would choose to be in if there were no regulation. Again, it is difficult to measure this inefficiency except to say that the benefits of rent regulation may be somewhat lessened.

1.2 Effects on Supply: Reduced Maintenance

If regulated rent increases are less than the market will bear, the return on maintenance expenditures may be reduced. Spending money on maintenancne may not increase a landlord's rental revenue. He can charge the full legal rent without suffering vacancies even if maintenance standards are reduced. One effect, theoretically, is for landlords to reduce expenditures on maintenance, renovation and conservation. Instead of re-investing in their building, landlords may invest in other ways which yield a higher rate of return than regulated units. As Hartle (1984) notes, possible gains to producers and consumers benefitting from the alternative investments will not offset the loss in consumer utility from the reduced stock of rental units (discussed in 1.3 below) and reduced maintenance expenditures. Thus, total output will fall. This also represents an economic cost to society.

With a cost-pass-through system, however, the maintenance disincentive may be somewhat alleviated.

To measure the effects of rent regulation, it is necessary to know what maintenance expenditures were before the introduction of rent regulation, what they were after rent regulation and how much of the difference, if any, can be attributed to the regulation of rents. This information is generally not available, although some efforts have been made to measure the changes in maintenance.

MOMAH (1982) tried to gauge tenant perceptions through surveys. Their results generally indicated that tenants thought maintenance was fine and had not been reduced significantly from the previous year. However, tenants may not be able to gauge maintenance beyond its cosmetic aspects. Other evidence presented to the Inquiry has indicated that upkeep of rental buildings is a serious matter requiring considerable expenditure of funds. With regard to high-rise buildings, for example, Klein and Sears (1983) argue that although short-term maintenance expenditures may not be reduced in response to rent review, preventive conservation expenditures such as weather protection, multi-storey parking garages, occupant safety, etc. will have been reduced. The effect of cutbacks in conservation expenditures may not yet have been felt by tenants interviewed since the consequences of foregoing these expenditures would become apparent over a longer period of time.

Although the evidence is somewhat difficult to assess, Ekos Research Associates (1985b) and Peter Barnard and Associates (1985) suggest that,

with regard to the low-rise sector of the Ontario rental housing market, there is a significant impact on maintenance expenditures and, more importantly, that this impact will be more apparent in the near future when the results of reduced maintenance become more obvious. Some, including Klein and Sears and Eph Diamond, have testified that maintenance expenditures in the Metropolitan Toronto area may have been reduced by as much as $4000 to $7000 per unit. If correct, these figures would suggest a significant reduction in expenditures but the numbers are difficult to substantiate.

None of the above evidence, however, indicates how much of the reduction in maintenance expenditures can be attributed to rent review in Ontario. As with other impacts, it is difficult to separate rent review from other factors such as high interest rates.

1.3 Effects on Supply: Losses to Rental Housing Stock and Supply of New Rental Stock

In addition to reducing maintenance expenditures, another effect on supply would be a reduction in the rental housing stock due to accelerated levels of demolition and conversions (for example, conversions to condominium units, equity co-ops and hotels). There may also be a reduction in new rental starts because of the risk that the regulation of rents might be extended to new units.[4]

[4]In December 1985, Bill 77 was enacted which extends rent controls to units over $750 per month. Units built after 1975, will be controlled when Bill 20 is enacted. Both of these types of units had been previously exempt.

Some evidence on the conversion to non-rental housing is provided by Klein and Sears (1985) for the City of Toronto where two-thirds of households are renters. Over the period 1976 to 1981, there were 11,300 new units added to the rental stock by means of new construction; 13,200 units were lost through demolition, conversion and de-conversion (to owner-occupied status with no tenants). Klein and Sears argue that the severe decline in owner-tenant dwellings was because of de-conversion to single-family homes ("gentrification") and because stringent security of tenure provisions in the Landlord and Tenant Act made it difficult for landlords to evict troublesome tenants.

A CMHC study for the City of Toronto shows that, over the period January 1978 to April 1985, the number of rental apartment units affected by demolition, renovation and conversion is a minimum of 8944 units or 11.1 percent of the existing private market rental stock in buildings of 6 or more units. See CMHC (1985, 2).

In other cities, over the period 1976 to 1981, losses from conversions and demolition were as follows:

	percentage of 1981 stock (%)
Toronto (City)	.8
Hamilton	4.0
North York	1.2
Ottawa	1.0
Kingston	1.5

Provincially, between 1975 and 1982, some 7,859 rental units were converted to condominiums (or .7 percent of the rental stock in 1981). For Toronto,

3,286 rental units were converted to condominiums or .71 percent of the 1981 rental stock.

Although the information provided by Klein and Sears indicates the number of conversions, this information has to be converted into a cost of rent review. Obviously, any decline in rental units will hurt tenants: vacancy rates fall, it becomes harder to find an apartment, landlords may discriminate against some prospective tenants and so forth. These types of costs are discussed further below.

To the extent that it is believed that rent review will be extended to new construction, this will reduce the level of expected profits from new rental units and reduce the supply of rental starts. This reduction comes about because of lower expected rents and the higher discount rate used to account for the increased risk associated with construction of rental units. Stanbury and Vertinsky (1985) show total rental starts for the period 1969 to 1984 for Ontario:

	Average annual rental starts
1969-74	37,641
1975-79	14,259
1980-84	14,491

In fact, a look at the annual data (Stanbury and Vertinsky (1985), p. 6-72) shows that rental starts began to decline as early as 1973 (prior to rent review in Ontario).

How much of the decline in rental starts can be attributable to rent review? Stanbury and Vertinsky (1985) suggest that there are many reasons why rental starts declined over the 1975 to 1984 period:

1) the number of household formations declined
2) real interest rates rose
3) the average annual unemployment rate rose
4) the rate of growth of real income per capita fell
5) certain tax advantages for rental construction were removed
6) tenant security of tenant measures were enacted
7) government supported rent-geared-to-income housing was increased

The March 1984 Ontario Housing Market Quarterly Review (pp. 7-8) suggested that rental housing starts will continue to decline, in part because of rent control, but also because of high land, construction and financing costs, existing zoning and planning laws, trends towards homeownership, preference by developers to build luxury condominiums, availability of better investment opportunities (industrial and commercial buildings) and the termination of the federal government's rental supply program (CRSP).

Thus, only a portion of the decline in rental starts can be said to have been caused by rent regulation.

Estimates of the decline in rental starts due to rent regulation are not easily available, especially for recent years. One possible way to estimate the decline in rental starts for 1984 would be to use the rental requirements for 1984 (based on demographic trends) in the absence of rent

review and compare that number with actual rental starts.[5] Foot (1985) estimates (based on the 1981 Census extrapolated to 1984 using 1984 demographic statistics) average annual rental housing requirements for the 1981 to 1986 period at approximately 20,300 per year. A straight comparison with MOMAH (1982) estimates of rental starts for 1984 of 9,400 units yields a shortfall of 10,900 units.

The next step is to add a 3 percent vacancy rate factor (.03 X 20,300) raising the shortfall estimate to 11,500 units ((1.03 X 20,300) - 9400). Replacement of the demolished stock is estimated to be between .0025 and .005 times the existing stock of 1.09 million units or between 2,725 and 5,450 units. The revised estimate of shortfall is 14,225 to 16,950 units.

Finally, an adjustment is required because data on rental starts only include row and apartment dwellings. Single detached and attached houses accounted for 28 percent of the occupied rental units in 1981. The revised shortfall figures are thus 10,200 to 12,200 units. This represents the decline in rental starts taking out demographic trends (and socially assisted housing). Other factors such as the termination of MURB's and high interest rates are still included (although nominal interest rates had fallen from the levels of the 1970's). Assuming these other factors account for 20 percent of the decline in rental starts, one might suggest that the decline in rental starts in response to rent review for 1984 was approximately 8,000 to 10,000 units.

[5]John Pringle, of the Commission staff, assisted with the preparation of this analysis and the compilation of numbers.

Again, the cost of this decline in rental starts will be in terms of increased search and transaction costs for tenants and prospective tenants. These costs are discussed in the next sub-section.

1.4 Increased Information, Search and Transaction Costs

The reduction in rental starts and losses through accelerated demolitions and conversions will serve to reduce vacancy rates over time (assuming no reduction on the demand side). With reduced vacancy rates from rent regulation, those who want to live in controlled units incur higher search costs and they potentially face demands for key money and discrimination. Evidence on vacancy rates and how they have changed can be found in Stanbury and Vertinsky (1985), pp. 6-85-6-97. Again, one has to be able to isolate the impact of rent regulation on vacancy rates. Vacancy rates can fall for other reasons, as well. There is limited evidence on the increased costs faced by tenants in terms of key money and discrimination, however. Some very preliminary estimates on search and queueing costs are mentioned below.

There are also compliance costs - those costs necessary to appear before the Residential Tenancy Commission to justify rent increases above the guidelines for landlords and to roll back increases on the part of tenants. Hartle (1984) attempts to estimate compliance (or procedural) costs.[6] For landlords, he estimates the cost for 1981 for appearing before the Residential Tenancy Commission and for conciliation proceedings at $5.4

[6]Hartle places procedural costs under rent-seeking activities (discussed in the next sub-section).

million.[7,8] To determine tenants' costs, Hartle estimates the tenants' participation rate on the number of controlled units in each size category and he calculates the number of contributing tenants. Assuming each tenant contributed (in cash or in kind) $5, the total cost to tenants for 1981 was estimated to be $2.25 million.

Finally, Hartle just assumes that search and queuing costs are $13 million or equal to total hearing costs (landlords', tenants' and the RTC's) plus total lobbying costs (see below). This amount is expected to decline over time as mobility rates fall and people become more familiar with the market.

Search and transaction costs are economic costs since the parties involved are using resources (time and money) to achieve certain results. Unfortunately, the measure of these costs are particularly crude, as Hartle himself notes.

1.5 Costs of Rent-seeking[9]

"Rents" (not the amount paid by tenants to landlords) are defined as the non-exclusive rights to income or wealth that have been created directly or indirectly by government intervention (Hartle (1984), p. 30). "Rent-seeking" is the struggle to secure a share of these non-exclusive rights

[7]This estimate is based on a study by Jordan and Geisel Management.

[8]The Residential Tenancy Commission allows landlords to pass through some of the costs of going to review to the tenants. It does not appear that Hartle has adjusted for this.

[9]This section is based on Hartle (1984).

(or to avoid the loss of such a share). The effort put forth in rent-seeking involves transaction costs which use up resources.

The cost of rent-seeking activities can be divided into two components: lobbying costs and procedural costs. Lobbying costs are those incurred when trying to get favourable (or restrict unfavourable) legislative and administrative policies. These costs, it should be noted, could also be incurred in the absence of controls. Procedural costs (or compliance costs) are those costs incurred in securing the favourable application (or avoiding unfavourable application) of existing laws and policies. These latter costs which are borne by landlords, tenants and taxpayers would only occur when controls are in place. Procedural costs were outlined in 1.4 above.

Hartle (1984), using several assumptions, makes some rough estimates of the costs of lobbying. Based on information from the Federation of Metro Tenants which suggests that one-third of its budget for 1982-83 was used for lobbying, Hartle applies this one-third figure to his estimate of the hearing costs for landlords and tenants. The estimate for lobbying costs on the part of landlords and tenants for 1981 is estimated to be $2 million. Although these are economic costs, the measures are crude and since it was argued that they would be incurred even in the absence of rent review, it is not clear how much of these costs should be attributed to that policy.

1.6 Direct Administrative Cost

The direct administrative cost to the Ontario government represents an economic cost in the sense that resources are being used up to administer rent review that could have been used elsewhere. The expenditures of the Residential Tenancy Commission for the 1984-85 fiscal year were $7.4 million.[10]

2.0 TRANSFERS

2.1 Direct Income Loss and Loss of Property Values

Rent controls have two effects: they change the expected return from controlled units and they change the risk. These effects differ depending on the form of the scheme used.

The direct benefits and costs for rent review can be summarized as follows:

i) tenants in controlled units pay lower rents than they would have in the absence of controls;[11]

ii) landlords of controlled units face a loss in rental income and a higher risk premium which result in a capital loss;

iii) tenants in uncontrolled units pay higher rents than they would have in the absence of controls;

iv) landlords of uncontrolled units receive higher rents because of the spillover of excess demand from the controlled sector but they also face higher risks. In theory, at the margin, the benefit is offset by the cost.

[10]Residential Tenancy Commission. Report to the Minister 1984-85.

[11]Estimates of the controlled rental stock are provided in a subsequent section. They represented approximately 80 percent of total rental units prior to December 1985.

In other words, two markets emerge where there are exemptions from rent review - controlled and uncontrolled - and there will be costs and benefits in each. To the extent that these represent transfers, not economic costs (because the losses to one group represent gains to another group), there is no overall loss to the economy.[12]

There is a case where an economic cost is incurred. If, for example, the risk factor increases because of rent control requiring an increased rate of return on new construction, there will be increased rents in new buildings. Tenants pay higher rents; landlords receive the same risk adjusted return as before. This difference in rents represents an economic cost. Also, to the extent that increased risk raises the cost of capital, there will be an overall loss to the economy.

To determine these costs, it is necessary to predict how much controls have reduced rents relative to what they would have been in the absence of controls and how much uncontrolled rents have increased. Unfortunately, this is very difficult to do since many other factors besides controls, have influenced rents over time. Again, it is difficult to isolate the impact of rent review.

Stanbury and Vertinsky (1985) summarize the data and analysis concerning the effect of controls on rents in Ontario. They conclude that rents are probably 11 percent lower in the controlled market than they would have been in the absence of controls, though they suggest that this figure might

[12]There is no loss unless one believes that money in the hands of landlords is worth more or, has a greater multiplier effect, than money in the hands of tenants. There is no evidence on this.

be somewhat overstated. Steele and Miron (1984) conclude that the effects of controls on rents was probably very small and probably less than the 7.5 percent used by MOMAH (1982). Fallis and Smith (1984) calculate that rents in the controlled market are approximately 11 percent lower than in the absence of controls. The latter authors also analyze rents in the uncontrolled sector and conclude that they are 10.3 percent higher because of rent review. In a more recent paper, Fallis and Smith (1985) maintain that rents are 11 percent lower in the controlled market but only 9.2 percent higher in the uncontrolled market.

There appears to be a range within which the reduction in rents on controlled units falls. For the remaining calculations of this paper, it will be assumed that rents in the controlled sector fell by somewhere between 7.5 and 11 percent. This includes the results of most of the major work concerned with the Ontario situation. With respect to uncontrolled rents, there is less evidence; the range to be used is a 9 to 10 percent increase in rents of uncontrolled units.

Thus, the costs to landlords of controlled units in terms of lost rental income is somewhere between 7.5 and 11 percent of gross rents; the loss to tenants of uncontrolled units is between 9 and 10 percent of their gross rents. As noted above, these are offset by gains to tenants in the controlled sector and landlords in the uncontrolled sector respectively and thus are <u>transfers</u> rather than economic costs.

The reduction in rental income immediately lowers the market value of the controlled property since the market value depends on the present

discounted value of expected rents.[13] The owner of the property at the time controls are imposed suffers a capital loss because he can no longer get a price for his property that reflects market rents. Landlords of controlled units may also suffer a capital loss resulting from an increase in uncertainty. The risk factor also tends to drive up rents in the uncontrolled sector to compensate for the risk that controls will be extended to that sector as well. As noted in Slack and Amborski (1984, pp. 6-7), the current rent review system in Ontario somewhat reduces the capital loss to landlords by allowing cost-pass-through.

Since the capital loss merely reflects the present discounted value of the reduction in rents, it is a transfer in the same way as is the loss of rental income. Stanbury and Vertinsky (1985) discuss whether the loss of property values is an economic cost or a transfer.[14] When controls reduce the market value of controlled buildings the wealth of the affected landlord falls. But this is a transfer, they argue, because there is no immediate impact in terms of the quality or quantity of rental housing available to tenants. In the longer run, however, if the supply of housing services from the existing stock falls (eg. through a reduction in maintenance) and if the supply of new units falls, then there is an economic effect on the supply of housing services. In other words, if landlords reduce maintenance or if less units are constructed, there will be an economic effect. Capital losses will not be realized until units are actually sold. Ideally, to examine capital losses incurred, information

[13]It is important not to double count the reduction in rental income and the reduction in capital values. Expected future losses in rental income will be capitalized into values today.

[14]In their terminology, they differentiate between a real cost and a financial or pecuniary cost.

would be required on market sales after controls were imposed for all controlled buildings. Then one could estimate both the size and the timing of the capital loss.

There is even less evidence on the reduction in capital values than there is on the impact on rents. Blatt (1982) analyzes the extent to which the capital value of rental units has been reduced using sale prices of apartments in Metro Toronto from 1970 to 1980. Although she concludes that actual selling prices are lower than what they would have been if they had increased at the rate of inflation, she does not calculate a capital loss.

Smith and Tomlinson (1981) conclude from TEELA data that capital values of apartment units were 20 to 30 percent lower in 1980 than in 1975 relative to the MLS value for all residential dwellings and condominiums in Metro Toronto. Stanbury and Vertinsky (1985) argue, however, that the pattern of changes in the nominal average price of rental units was less regular than Smith and Tomlinson have suggested. Also, they point out that other factors besides rent control influence market values such as the tax position of the owner and opportunities for capital gains when the property is sold. There is slim evidence on capital values and what there is appears to overstate the effects of rent review somewhat.

In terms of the economic costs of rent review, as noted above, the only aspect of the discussion in this section that is relevant is the impact of the loss in capital values on maintenance and rental starts. Both of these were discussed above in sections 1.2 and 1.3. In terms of the transfer, the loss in rental income to landlords is estimated to be between

$259.3 million and $377.3 million. See section 3.1 below for the calculations.

3.0 OTHER COSTS TO GOVERNMENT

3.1 Foregone Tax Revenues[15]

Rent control, unlike the other programs to be addressed in this paper, does not involve a direct subsidy from government. Rather, as noted above, the subsidy is from landlords of controlled units to tenants of controlled units. However, this does not necessarily mean that rent control is costless to government. The government incurs direct administration costs through the operation of the RTC (section 1.6 above), it may incur additional expenditures to stimulate rental housing construction (section 3.2 below) and finally, it will receive less revenues from taxes than it would in the absence of rent review because the taxable rental income from controlled units is reduced relative to what it would have been in the absence of controls.

This section considers foregone tax revenues to governments at all levels. Revenues from four taxes are particularly affected by rent review: income tax, property tax, capital gains tax and corporation capital tax. Although reduced taxes represent a cost to government, they are not considered as a cost to society. On the contrary, they provide a benefit to taxpayers. However, it is useful to determine the amount of foregone revenue to compare the costs of rent review with the costs of other housing

[15]It should be noted that, with the exception of the capital gains tax, all taxes foregone would likely be higher in the future because of recent legislation which eliminates exemptions from rent review.

programs since both increased expenditures and reduced taxes represent costs to government. Assuming other government expenditures remain the same, there will either be a shift in the tax burden to other taxpayers or an increased level of debt to be borne by taxpayers in the future. In terms of the earlier discussion of economic costs and transfers, foregone tax revenues would not be considered to be an economic cost.

To calculate foregone tax revenues, it is necessary to have information on many aspects of the impact of rent control on rental starts, on rents, on maintenance and other factors. As already discussed, information on these issues is sparse and estimates are somewhat unreliable in many cases. This means that any estimates of foregone tax revenues will be very rough. In many cases, ranges of estimates are provided.

The only study of rent review in Ontario which looks at foregone tax revenues is Smith and Tomlinson (1981) who provide a "back of the envelope" (p.107) type calculation. MOMAH (1982) modifies these estimates somewhat. The "method" used in Smith and Tomlinson (1981) for 1980 is applied in this paper to derive a range of estimates of foregone tax revenues for Ontario for 1984.

Income Tax

The loss of income tax revenues on controlled units results from the loss of rental income on these units. The first step, then, is to calculate the decline in rental income due to controls. This is calculated as the difference between what the rental income would have been in the absence of controls and the actual rental income (with controls). Assuming that rents

were reduced by between 7.5 and 11 percent because of controls,[16] and assuming the average rent for controlled units was $390,[17] rents would have been between $421.62 (calculated as 390/[1-.075]) and $438.20 (calculated as 390/[1-.11]) in the absence of controls. Finally, assuming that the number of controlled units was between 820,000 and 830,000,[18] then the rent reduction was between $311.1 million and $474.3 million.

The second step is to subtract the vacancy loss. If there were no controls, the vacancy rate would have been higher. Therefore, it is necessary to reduce the amount of rent reduction by the vacancy loss. Assuming that the actual vacancy rate in 1984 was .75 percent[19] and that it

[16]See the discussion in section 2.1 which summarizes the results of various studies on the rent reduction.

[17]The $390 figure is based on CMHC estimates by regulatory status for the CMA's. These estimates are $418 for a 2-bedroom unit in privately initiated buildings containing 6 or more units. This estimate is somewhat overstated, however, because rents in CMA's were 9 percent higher than provincial rent levels and because average rents for all unit sizes were 7 percent lower than for 2-bedroom units (according to the April, 1985 CMHC vacancy rate surveys). On the other hand, the 1981 Census reports that rents in apartment units were 3 percent lower than overall rents. But, as Muller (1985) reports, 14 percent of apartment units were socially assisted (not under controls) compared to 13 percent of the overall stock.
It is difficult to adjust the $418 number for all of these discrepancies. The estimate of $390 is used here - it represents the $418 reduced by 7 percent to account for unit size differences.

[18]The estimate of regulated rental stock is based on Pringle (1985) which states that the number of units subject to regulation in 1981 was 837,000. Assuming the loss of regulated units was constant between 1976 and 1984, yields an estimate of 825,000. This implies a constant annual loss of regulated units equivalent to 0.5 percent of the 1976 stock due to demolitions, the $750 exemption and conversions to ownership. Because 825,000 is only an approximation, a range of 820,000 to 830,000 units is used in the analysis.

[19]This number is the CMHC estimated vacancy rate of 0.75 percent.

would have been 3 percent for an 11 percent rent reduction and 2 percent for a 7.5 percent rent reduction, the vacancy loss is calculated to be between $51.9 million and $97.0 million.

Thus, the loss in rental income is estimated to be between $259.3 million and $377.3 million.

The third step is to calculate the net income tax effect on each dollar that rental income declines. This is done by comparing the tax revenue on the marginal rental dollar received by the landlord with the tax revenue on the marginal rental dollar saved by the tenant.

Consider the case where rent controls reduce rent by $100 and then compare the income tax revenues collected without controls and with controls. In both cases, we are considering $100 of tenants' money. In one case it goes to landlords; in the other case tenants spend (at least a portion of it) on other goods and services. In the scenario without controls, the $100 is paid by tenants to their landlords and landlords pay tax on the $100. Under the scenario with controls, tenants spend some portion of the $100 on domestic goods and services, the remaining portion being saved or spent on imported goods. This spending on the part of tenants will generate income for the suppliers of goods and services and thus generate income tax revenues.

One could take this analysis further and consider many rounds of spending by landlords and the suppliers of other goods and services. Each round of spending generates incomes and income tax revenues. If we summarize the tax revenues generated by landlords and the tax revenues generated by

tenants and compare them, we can determine the net tax loss per dollar that rental income declines. This estimate multiplied by the decline in rental income gives the income tax loss.

The net tax loss per dollar of reduced rental income is estimated to be between .20 and .27.[20] The .27 estimate implies an offset of 23 percent; the .20 estimate represents an offset of 43 percent. In other words, the loss in income tax revenue from reduced rental income of landlords is offset by 23 to 43 percent by tenants' spending.[21]

The .27 estimate is based on the following assumptions:[22] the landlords spend $.05 per marginal dollar of revenue on maintenance, leaving $.95 as taxable income. At a marginal tax rate of 35 percent, the effective tax rate for the landlord is .335 (calculated as 0.95 X 0.35). The supplier of other goods and services spends 70 percent of the marginal dollar on materials, wages etc., leaving only $0.30 for taxable income. Therefore, his effective tax rate (assuming the same marginal rate) is 0.12 (calculated as 0.3 X 0.35). Third, it is assumed that some portion of income (for landlords, tenants and other suppliers) is saved or spent on imports thus not increasing taxable income in Canada. Assuming 10 percent is saved and 25 percent of the remaining $0.90 is spent on imports, there will be leakages of .325 (calculated as 0.1 + [.9 X .25]).

[20]The derivation of the formula used to arrive at these estimates will be provided in a technical appendix to the paper.

[21]This assumes a marginal tax rate of 35 percent.

[22]These are basically assumptions provided by Professor Larry Smith.

To arrive at the .20 estimate, the assumptions were altered somewhat. First, the effective tax rate on other suppliers was increased to .22 to reflect other taxes that would increase - sales taxes and import duties. Second, the leakages were reduced to .25, assuming that nothing is saved out of each marginal dollar and 25 percent of the entire dollar is spent on imports.

The estimate of income tax losses is thus between $51.9 million and $101.9 million for 1984. There are two major underlying assumptions which determine the magnitude of the income tax loss. The first is that there are leakages in tenant spending. In other words, without rent controls the entire $100 goes to landlords whereas with rent controls, tenants only spend a portion of the $100 on domestic goods and services. Second, the effective tax rate of landlords is significantly larger than the effective tax rate for other suppliers because the landlords are taxed on 95 percent of the income collected (5 percent goes to maintenance) and other suppliers are taxed on only 30 percent of the income collected (70 percent is spent on wages, materials etc.).

One might also want to consider the increased income tax revenues from the increased rental income on uncontrolled units. Smith and Tomlinson (1981) do not make these calculations presumably because capital cost allowance and mortgage interest deduction provisions shelter rents for about 9 years. Since units built after 1975 were uncontrolled, there has probably been no immediate tax increase to date.

Property Tax

There are two aspects of rent review which could potentially result in reduced property tax revenues: the decrease in construction of rental buildings and the reduction in market values. To offset these reductions, there may be an increased supply of other types of buildings and increased market values for uncontrolled buildings. Each of these is outlined below.

The decrease in construction of rental buildings in response to rent review was discussed in section 1.3 above. Assume that the decline in rental starts for Ontario over the 1976-84 period in response to rent review was between 70,000 and 80,000 units.[23] Average residential property taxes per household (net of property tax credits) for Ontario for 1984 were $879.[24] Because most of the province is not on market value assessment, a number of discrepancies exist in the assessment system. In particular, apartments are assessed at a higher ratio of market value than are single-family homes. Thus, it is necessary to adjust average residential property taxes upward for apartments. A figure of $1000 (or about 10 percent higher) is used for property taxes on apartments. This would mean a loss in municipal property taxes of between $70 million and $80 million.

There would be an offset in terms of increased property tax revenues from condominiums. Since it is difficult to know what proportion of

[23]The estimate of 80,000 is based on the method used for 1984 and assumes a constant shortfall in each year between 1976 and 1984. The estimate of 70,000 takes account of fluctuations in the decline in rental starts.

[24]This estimate for 1984 was taken from Local Government Finance in Ontario, 1983, Ministry of Municipal Affairs and Housing, p. 12. The estimate is per household so it is assumed that there is one household per unit.

condominiums were built in response to rent review, no estimate is made here. However, it should be noted that the numbers in the text are somewhat overstated.

Also, because of the current system used for assessment of property in Ontario, the numbers for increased revenues for condominiums and decreased revenues for apartments would not be strictly comparable. Condominiums now, though not always,[25] are taxed as single-family homes rather than as apartments. As noted above, apartments are assessed at a significantly higher ratio of market value than are single-family homes (and now condominiums). This means that an apartment worth the same amount as a single-family home (or condominium) pays more in property taxes than the single-family home (or condominium). Some of the province now uses market-assessment and, in those municipalities, this discrepancy would not arise. However, over one-half of the municipalities in Ontario are under S.63 of the Assessment Act and these discrepancies remain. Under S.63, municipalities can, at their option, apply to the province for a limited form of reassessment within classes of properties. Properties are divided into 13 classes - single family home, apartments of 2 to 5 units and so forth. Reassessment is done within those narrowly-defined classes but the discrepancies between classes of property remain. The City of Toronto has not applied for reassessment under S.63 and assessments are still based on 1940 values. This means that the decline in property taxes is still somewhat overstated but not by as much as it would be under a true market value system.

[25]See Goyette (1985) for a discussion of the tax treatment of condominiums.

The second aspect of the property tax change results from adjustments in the market value of buildings (controlled and uncontrolled). One would expect that if rents were reduced below their market level, that the market value of the property would fall, the assessed value would fall and property taxes would also be reduced. Similarly, the market value might increase on uncontrolled units.

However, in the City of Toronto, assessments are frozen at 1940 market values and thus property taxes would not change. Under S.63 of the Assessment Act, property taxes overall would also not change because the total assessment for all apartments would remain the same.[26]

Thus the overall effect of rent review on municipal property taxes under the current system in Ontario would be between $70 million and $80 million.

Capital Gains Tax

A third tax that might be affected by rent review is the capital gains tax. Capital gains tax losses reflect the change in capital values (which capitalize the rent reduction). Although recent legislation exempts the first $500,000 of capital gains for taxation purposes,[27] this provision did not affect 1984 tax collections. Thus, although this tax is much less significant in terms of the impact of rent review now and in the future, estimates are provided for 1984.

[26]It is expected that some form of market value assessment will be initiated across the province shortly. However, if it means that s. 63 will be applied everywhere, then the above statements remain true. If full market value is brought in (which is not likely) then the effects would be different.

[27]See Federal Budget, May 1985.

In 1984, one-half of capital gains were taxable. Assuming the rate of turnover (rate of sales) for 1984 was 30,000 units,[28] and assuming capital values on controlled units fell by about 30 percent[29] and the average apartment value was between $20,000 and $28,000,[30] the capital gains tax (at a 40 percent marginal rate)[31] would have fallen by between $56 million and $50.4 million.

One should also consider the potential offset from higher values in the uncontrolled sector that might be subject to the capital gains tax. Higher initial rents will not necessarily alter the present value of expected future rents in which case capital values would not change much and the capital gains tax would not be increased. Since information on changes in capital values in the uncontrolled market is even sketchier than in the controlled market, this offset is omitted except to note that the above calculations on the capital gains tax reduction may be somewhat overstated.

[28]This estimate is based on TEELA data for 1981 for Metropolitan Toronto.

[29]This is based on Smith and Tomlinson (1981).

[30]This range is based on the Permanent I.C. & I Real Estate Review for Ottawa and Toronto. It has been adjusted to reflect values for the entire province.

[31]When a property is sold, excess depreciation taken in the past is recaptured, in addition to the capital gains. The total rate may be very significant to a landlord, putting him/her into a higher marginal tax bracket than would ordinary income. Since values probably did not go below the purchase price, however, (with the possible exception of some 1974 and 1975 purchases), the recapture is probably not all that significant.

Provincial Capital Tax

The Ontario capital tax is calculated as 0.3 percent of paid-in capital of corporations.[32] These tax revenues would be reduced by rent review in the case of sales of controlled units assuming higher prices would have been financed by higher mortgages. Also, tax revenues would be lower because the number of new units would have fallen. Assuming 75 to 85 percent of financing would have been mortgages, 35 percent of total controlled units are in buildings of 50 units or more and are corporately owned,[33] 30,000 total units were sold in 1984 at an average decline in value of 30 percent of $20,000 to $28,000 and also assume the decline in new units was 8,000 to 10,000 at an average price of $50,000 to $60,000, the loss in capital tax revenues would be equal to between $2.3 million and $3.8 million.[34]

Table 1 provides a summary of foregone tax revenues for Ontario for 1984. Upper and lower limits are provided since a range of assumptions was used to derive estimates. It appears that the most significant tax loss is for the property tax levied by municipal governments. However, caution is advised in interpreting these estimates because of the underlying assumptions.

[32]For capital under $100,000, the tax is $50; for capital under $1 million, the tax is $100. Assuming an average per unit price of around $20,000, only buildings with 50 or more units would have the 0.3 percent rate apply.

[33]This is based on TEELA market estimates for 1980 as found in MOMAH (1983) Staff Report to the Commission of Inquiry into Residential Tenancies.

[34]Since the loss is based on reduced capital values in each year, the estimates for the year 1984 are multiplied by a factor of 5 to reflect the cumulative effect.

Table 1

Loss of Potential Tax Revenues

Ontario, 1984

($ millions)

	lower limit	upper limit
income tax	51.9	101.9
property tax	70.0	80.0
capital gains tax	36.0	50.4
provincial capital tax	2.3	3.8
TOTAL	160.2	236.1

5.2 Additional Expenditures/Tax Expenditures

Some authors have argued that rent review, because it has reduced the supply of rental housing, has necessitated additional government expenditures (and tax expenditures). See, for example, Smith and Tomlinson (1981). Even if one accepts that rent review has reduced rental housing starts and that additional government expenditures were made because of rent review, it is difficult to establish which programs and how much of any government expenditure was made in response to rent review.

This section addresses this issue in two parts. First, it identifies which federal and provincial government programs are designed to stimulate rental supply and how much was spent on each in Ontario in 1984. This assumes that rent review has some effect only on supply programs. Second, it attempts to determine what percentage of these expenditures can be attributed to rent review in Ontario.

The programs that appear to be supply-related are the following:[35] Ontario Rental Construction Loan Program (ORCL), Canada Rental Supply Plan (CRSP), Assisted Rental Program (ARP), Ontario Rental Construction Grant (ORCGP), Rent Supplement Program and Multiple Unit Residential Buildings (MURB's).[36] Each of these is discussed briefly. Where the programs are federal, an estimate is made of how much was spent in Ontario.

[35]This description does not include the most recent Ontario changes, December 1985.

[36]The descriptions of these programs which follows is based on information prepared by Pearl Ing, Commission of Inquiry into Residential Tenancies. The cost estimates were prepared with the assistance of C. B. Carr, Manager, Programs Administration, Ontario Housing Corporation, Field Operations.

1) Ontario Rental Construction Loan Program (ORCL)

ORCL was initiated by the province in 1981 to stimulate the construction of rental housing in Ontario, particularly in municipalities where vacancy rates were low. Under this program, the Ontario Mortgage Corporation provided interest-free loans to private builders for the construction of rental projects and for the conversion of non-residential properties to rental accommodation. The loans amounted to $47,140,000. The cost to government in 1984 is equal to the interest foregone on these loans. Assuming an interest rate of 12 percent[37] in 1984, the total cost is estimated to be $5,656,000.

2) Canada Rental Supply Plan (CRSP)

CRSP was initiated by the federal government in 1981 and was terminated in 1984. It was not unlike ORCL above in that it was designed to stimulate the construction of rental accommodation in areas with low vacancy rates by providing interst-free loans. The cost in 1984 is equal to the interest foregone on $77 million. Again, assuming an interest rate of 12 percent, the estimated cost is $9.24 million.

3) Assisted Rental Program (ARP)

ARP was a federal program from 1975 to 1978 (in 1978 it was phased out as the Graduated Payment Mortgage Plan developed). ARP was designed to

[37]This is based on Government of Canada, average bond yields.

stimulate the construction of moderately priced rental housing by providing interest-free loans to reduce rent levels to the market rents of similar existing units. A modification in 1978 changed ARP from an interest-free loan to a graduated mortgage type of scheme. The estimate for federal assistance under ARP for 1984 is $10.5 million.[38]

In addition to the federal program, there is a private assisted rental program in Ontario (which begain in 1976) designed to stimulate private sector participation in the provision of rent-geared-to-income housing units. The operating costs of this program are divided equally between the federal and provincial governments. Under this program, a subsidy is provided to builders to build and manage rental projects where the units are made available to persons on the waiting list for assisted rental housing. The difference between the rents paid by tenants and market rents is subsidized. Cost estimates for private ARP are combined with the Rent Supplement below.

4) Ontario Rental Construction Grant (ORCGP)

ORCGP, which ran from 1977 to 1981, provided additional assistance when that provided under ARP was insufficient to facilitate the production of moderately priced rental units. Assistance was in the form of a grant to builders who were already receiving the maximum ARP. The cost, for 1984, for ORCG is estimated to be $3.0 million for the provincial government.

[38]C. B. Carr, Ontario Housing Corporation.

5) The Rent Supplement Program

The Rent Supplement Program which began in 1971 is designed to provide assisted rental housing for low income families and seniors. The province acquires the use of rental accommodation from private landlords and makes them available to low-income families and seniors on a rent-geared-to-income basis. Tenants pay a portion of their rent directly to the landlord; the difference between this amount and the market rent is paid by the Ontario Housing Corporation. The combined budget for the Rent Supplement Program and private ARP for 1983-84 was $17.5 million. The federal share was also $17.5 million.

6) Multiple Unit Residential Buildings (MURB's)

This federal tax expenditure began in 1974 and was terminated at the end of 1982. Its purpose was to encourage the development of multiple unit residential buildings for rental purposes. This was a tax deferral program in which owners of eligible rental units could defer tax on non-rental income by writing off certain costs and by using a capital cost allowance (CCA) on an ongoing basis. This loss could be sheltered against other income. The estimated cost of MURB's for 1983 is $21.7 million.[39]

The total estimated cost of all the rental supply programs in 1984 in Ontario is $58.9 million for the federal government and $26.2 million for the provincial government. These programmes are summarized in Table 2.

[39]Government of Canada. Tax Expenditure Account. This is based on an estimate of $65 million for Canada for 1983. It has been divided by 3 to derive an estimate for Ontario.

The next issue is how to evaluate how much of these expenditures can be attributed to rent review in Ontario. As discussed in a previous section of this paper, the decline in rental starts could only partly be attributable to the introduction of rent review in 1976. Firstly, rental starts began to decline as early as 1973 prior to rent review. Secondly, many other reasons for the reduction in rental starts are valid - high interest rates, escalating building and land costs, changing demographics and other factors.

Smith and Tomlinson (1981) assume that 50 percent of rental supply expenditures can be attributed to other factors leaving 50 percent in response to rent review. MOMAH (1982) accept this breakdown in their estimates as well. In light of the above factors, it appears that 50 percent may be somewhat high, however. Thus, it is assumed that between a 25 percent and 50 percent of these expenditures were in response to rent review. However, these assumptions are arbitrary. This means that expenditures made in response to rent review range from $21.3 million to $42.6 million. Table 3 summarizes the expenditures made in response to rent review.

A consideration left out in other studies is the impact of rent review on the <u>reduction</u> of some government expenditures on housing, particularly on the demand side. For example, it could be argued that expenditures on the Rent Supplement Program which makes units available to low-income families and senior citizens on a rent-geared-to-income basis have been reduced because of rent review. It is very difficult to estimate the magnitude of

this reduction but it should, at least, be noted that the costs in Table 2 may represent an over-estimate even where the lower estimates are being used.

Finally, to the extent that these supply-related expenditures provide loans and assistance to builders they can probably be considered to be transfers rather than economic costs, with the exception of the funds used to administer these programs.

Table 2

Summary of Government Expenditures on Supply-Related Programs, Ontario, 1984[1]

	Estimated Cost 1984 ($,000)	
	provincial	federal
ORCL	$5,656	-
CRSP	-	$9,240
ARP	-	$10,500
ORCGP	$3,030	-
Rent Supplement and Private ARP	$17,500	$17,500
MURB's	-	$21,700
TOTAL	$26,186	$58,940

Note: 1) These are total expenditures. Not all of these can be attributed to rent review.

Table 3

Summary of Government Expenditures on Supply-Related Programs in Response to Rent Review, Ontario, 1984

($,000)

	Provincial		Federal		Total	
	upper limit[1]	lower limit[2]	upper limit	lower limit	upper limit	lower limit
ORCL	$2,828	$1,414	-	-	$2,828	$1,414
CRSP	-	-	$4,620	$2,310	4,620	2,310
ARP	-	-	5,250	2,625	5,250	2,625
ORCGP	1,515	758	-	-	1,515	758
Rent Supplement and Private ARP	8,750	4,375	8,750	4,375	17,500	8,750
MURB's	-	-	10,850	5,425	10,850	5,425
TOTAL	13,093	6,547	29,470	14,735	42,563	21,282

Notes: 1) The upper limit assumes that 50 percent of expenditures are in response to rent review.

2) The lower limit assumes that 25 percent of expenditures are in response to rent review.

4.0 SUMMARY

Table 4 provides a summary of the costs of rent review in Ontario (largely based on 1984 estimates) for economic costs and transfers. Although the literature on rent regulation discusses the impact of rent regulation at great length, few dollar values are ever attached to the impact. This paper has attempted to estimate these costs.

The importance of these costs is based, to some extent, on their magnitude but that is not sufficient to evaluate the impact of rent review. For an economist, the economic costs are the most significant because resources may be being wasted. For landlords, tenants and politicians, on the other hand, the transfers may be the most significant costs. If rent review redistributes income from landlords to tenants, there may be no direct loss in terms of ouptut, but the consequences of this redistribution can be very significant for the parties involved.

In terms of government costs, the most significant ones seem to be foregone property tax revenues and the government expenditures on supply-related programs. It should be remembered that property taxes are municipal revenues; housing expenditures are partly federal and partly provincial.

Again, it is important to realize firstly that the numbers provide a very crude approximation of the costs of rent review and secondly, that the magnitude of the costs may not be the most important consideration, in any event. Finally, the costs of any policy have to be weighed against the benefits.

Table 4

Summary of Costs of Rent Review, Ontario, 1984

	($ millions)
Economic Costs	
Reduced maintenance	?[1]
Search and queueing	$13[2]
Compliance costs	7.64[2]
Lobbying costs	2.0[2]
Administrative costs	7.4
Transfers	
Reduced income for landlords	$259.3 to $377.3
Foregone tax revenues - income tax	$51.9 to $101.9
- property tax	$70.0 to $ 80.0
- capital gains tax	$36.0 to $ 50.4
- capital tax	$ 2.3 to $ 3.8
Other government expenditures (including ORCL, CRSP, ARP, ORCGP, Rent Supplement, MURB's)	$21.3 to $42.6

Notes: 1) No reliable estimates have been made of the impact of rent review on maintenance expenditures, as apart from other factors.

2) These are estimates for 1981.

Chapter 3: COSTS OF HOUSING ALLOWANCES

1.0 HOW DOES A HOUSING ALLOWANCE WORK?

A housing allowance (also referred to as a shelter allowance) is a cash payment made on a regular basis to households to allow them to afford "adequate" housing. The payment depends both on the household's housing expenditures and on its income. The purpose of a housing allowance is to reduce a housing affordability problem by subsidizing low-income renters. It also increases security of tenure because, when incomes of households fluctuate, the allowance helps them to stay in their unit.

Under the usual formula, renters[40] receive a payment equal to a set percentage of their "affordability gap" where the affordability gap equals the amount by which rent exceeds a set percentage of income. The actual rent is used in the formula except when it is relatively high in which case a "threshold" (or maximum allowable rent) is specified. The most common formula is as follows:[41]

[40]Generally, housing allowances in Canada (B. C., Manitoba and Quebec) only apply to renters. For a discussion of the rationales for extending it to homeowners, see Steele (1985), pp. 31-34.

[41]Chant (1985) considers both "restricted" and "unrestricted" housing allowances. The one described here is "restricted". An "unrestricted" allowance would transfer an amount equal to the difference between the household's income and the cost of some standard housing. Thus the household is not required to meet any spending level to qualify for the allowance. Since such a program is not common in Canada and since it is really more of an income subsidy than a housing subsidy, it is omitted as a housing policy to be compared with rent review. The cost estimates in this chapter are for a "restricted" housing allowance scheme.

$$Hi = A\,(R_i - cY_i) \quad \text{for } R_i < R^*$$

$$\text{and} \quad Hi = A\,(R^* - cY_i) \quad \text{for } R_i > \text{or} = R^*$$

where Hi = housing allowance for household i

A = set percentage

R_i = rent of household i

c = set percentage

Y_i = income of household i

R^* = threshold rent

Note that c, the percentage of income can be fixed (a constant contribution rate, CCR) or variable (a variable contribution rate, VCR) depending on the number of persons in the household.

2.0 ECONOMIC COSTS

2.1 Effects on Demand

The economic (or efficiency) costs of a housing allowance are considered to be small relative to other housing expenditures. A housing allowance increases the disposable income of low-income households and also reduces the effective rent per unit of housing service because the cash payment increases by "A" percent for every increase in rent (below the threshold) of $1.00. The increased income coupled with a reduction in the effective rent would theoretically be expected to increase housing demand. However, the empirical evidence presented by Steele (1985) strongly suggests that the demand for housing does <u>not</u> increase significantly in response to a housing allowance. Both U. S. evidence for the Experimental Housing Allowance Program (EHAP) and Canadian evidence from Manitoba suggest little increase in demand. Movers do not improve their accommodation by and large

and, those paying more than threshold rents cannot get an increased subsidy even if they did upgrade their accommodation.

This lack of behavioural response on the part of allowance recipients is explained by Steele by low income and price elasticities of housing demand for low income households. A high percentage of these households are already spending more of their income on housing than they would like (leaving insufficient money for food, clothing, etc.). In addition, they find it difficult to reduce their expenditures on accommodation because this would involve moving costs and because building codes and housing standards prevent them, in many cases, from finding cheaper accommodation.

The evidence on housing demand summarized in Steele (1985) seems to be very strong - it shows there is no behavioural response. It should be noted, however, that the programs in question are fairly limited in terms of beneficiaries generally including the elderly and sometimes families. A program extended to <u>all</u> renters, however, might be expected to produce a more significant impact on housing demand.

Still on the demand side, Steele (1985) considers rent inflation resulting from housing allowances. She describes two possible scenarios. In the first, housing allowances increase demand causing vacancies to fall in the short run and rents to increase. This would affect all renters not just housing allowance recipients. In the long run, rent increases would result in new construction but there will still be problems created by the temporary rent increase and by the increased construction not reducing rent in old, low quality buildings where low-income households live.

In the second scenario, housing demand would not increase in response to housing allowances but landlords would exercise any monopoly power to raise rents.

As with effects on housing demand, Steele found that no significant rent increases resulted from housing allowances. The rate of rent increase in Manitoba was less than the rate of rent inflation (as measured by the rental component of the CPI). Also, the rate of market rent increase was similar in Canadian cities with and without housing allowance programs.

One reason for the absence of rent inflation logically follows from the evidence on housing demand. If demand did not increase in response to housing allowances, then, ceteris paribus, rents would not be expected to increase. In terms of the monopoly power of landlords, the argument breaks down, according to Steele, because they do not necessarily know which of their tenants are housing allowance recipients. On the other hand, one might expect that a landlord of a low-rent building might assume that the majority of tenants are at least eligible for housing allowances even if they do not receive them.

The effect of housing allowances on housing demand and rents is an important element of economic cost. The empirical evidence suggests that this aspect of economic cost for housing allowances is virtually zero. The importance of effects on housing demand and on rent inflation for the subsidy cost of the program is discussed further in section 4.0 below.

2.2 Effects on Supply

Housing allowances do not have an effect on supply. They will not stimulate new construction. As Steele (1985, pp. 20-21) notes, if a tight market exists because of the gap between rents for older units and the breakeven rent required for new units, housing allowances will not reduce that gap.

2.3 Information, Search and Transaction Costs (compliance costs)

These costs include the costs to the public of responding to the shelter allowance program. Households have to establish and maintain their eligibility for the allowance and, if there are expenditure requirements, they may have to document their housing expenditures. Steele estimates that the forms required to fill out are of the same degree of difficulty as a personal income tax form, perhaps requiring one day of a person's time. One could possibly estimate the cost of filling out forms by the minimum wage for families (or about $3.50 per hour in Ontario in 1984), and perhaps one-half of the minimum wage for the elderly (since their opportunity cost is presumably lower). With a constant contribution rate plan (CCR), the elderly represent half of the total number of participants. Steele estimates the total number of recipients for 1984 in Ontario (assuming median threshold rents) would have been 53,000.[42] Thus, the cost would be

[42]Since there is no housing allowance in Ontario now, the number of participants is only an estimate based on certain assumptions about how the plan works. One could consider alternatives such as a variable contribution rate plan, 33 1/3 percentile threshold rents, only families included and other options. Each of these alternatives would result in a different number of participants and different costs.

equal to [1/2 X $3.50 X 8 hours X 53,000] + [1/2 X 1/2 X $3.50 X 8 hours X 53,000] = $1,113,000.

This cost estimate only looks at filling out forms. One would have to add an estimate of the costs involved in finding out about the program and so forth. No estimates have been made of these types of costs.

2.4 Costs of Rent-seeking

As noted in the section on rent review, these costs include lobbying costs and procedural costs. Although no estimates exist of the costs of these activities, one can assume that some expenditures are made by groups such as Social Planning Councils and tenants' organizations to lobby for housing allowances.

2.5 Direct Administrative Costs

Chant (1984) notes that the direct administrative costs to government for housing allowances are very low. Kershaw and Williams (1981) identify four different types of administrative costs:

i) identifying those eligible to apply for benefits and informing them;

ii) determining eligibility for benefits on the basis of income and family size;

iii) assisting applicants in meeting the requirements of the program;

iv) ensuring applicants occupy housing that meets the required standards (if there are any as part of the program).

Steele[43] argues that the cost of administration is greater for families than for the elderly. Specifically, she believes that the cost for families is four times as great as the cost of administration for the elderly. She also assumes that the cost for the elderly is approximately equal to 3 percent of the total benefits; the cost for families would thus be 12 percent of total benefits.[44] Assuming a 60 percent participation rate and using median rents as threshold rents, she notes that there would be 53,000 recipients under a CCR plan. Total benefits for 1984 would be $53 million. Thus, administrative costs for a housing plan for 1984 would be approximately equal to [3% X 1/2 X $53 million] + [12% X 1/2 X $53 million] = $3,975,000. No other estimates of administrative cost have been made for Ontario.

3.0 TRANSFERS

Under rent review, there is a redistribution among landlords and tenants. With a housing allowance, the redistributive impact is somewhat different. As Chant (1985) notes, with any subsidy program such as this, it is necessary to consider how it is being financed and then the sum of the distributional effects of the subsidy and the method of financing needs to be calculated. Suppose, for example, that a provincial housing allowance program is financed by a progressive income tax. Then, presumably, relatively more benefits would be received by low-income groups and relatively more costs would be borne by high-income groups. This would

[43]These points were raised in discussion.

[44]She also suggested that the guaranteed income supplement (GIS) would be expected to have similar administrative costs since the forms are roughly the same.

then be a "progressive" program - redistributing income from high-income to low-income households. It is more likely that a shelter allowance would be financed out of general revenues, however. Thus, one would need to compare the incidence of general revenues with the incidence of the shelter allowance program. Less information is available on the incidence of general government revenues.

The subsidy cost discussed in section 4.0 below is part of this redistributive cost.

4.0 COSTS TO GOVERNMENT

4.1 Direct Subsidy Cost

By far the largest cost of a housing allowance program is the direct subsidy cost to government. Since there currently is no housing allowance program in Ontario, direct subsidy costs can only be estimated for various types of schemes. The costs can vary greatly depending on the choice of variables A, c and R* in the formula $H_i = A\ (R_c - c\ Y_i)\ \ R_c < R^*$ and also on the choice of groups to be targetted, eg. elderly only, families only, all renters, renters and homeowners, etc. It would be easier and probably would make more sense to start with a given predetermined subsidy cost by government, and then the choice of recipients and parameters could be determined to achieve that total cost. However, what is available is an estimate based on the most common type of program used elsewhere and applied to Ontario in 1984.

Steele provides some cost estimates for 1984 for Ontario based on the following formulas:

$H_i = .75 (R_i - .3Y_i)$ for a constant contribution rate (CCR)

and $H_i = .75 (R_i - cY_i)$ for a variable contribution rate (VCR)

where c = .375 for singles
= .30 for 2-person household
= .25 for 3-person household
= .225 for 4-person household
= .20 for 5 or more person households

These alternative programs are targetted to the elderly and families only and she assumes a 60 percent participation rate (which reflects actual participation rates for similar existing programs in B. C., Quebec and Manitoba). For a 33.3 percentile threshold rent, her estimates for 1984 are as follows:

	No. of recipients	Total payments
Constant Contribution Rate (CCR)	49,000	$44 million
Variable Contribution Rate (VCR)	51,000	$45 million

For median rents as threshold rents, her estimates for 1984 are:[45]

	No. of recipients	Total payments
CCR	53,000	$53 million
VCR	56,000	$54 million

These estimates are somewhat overstated because they do not take account of the deduction from the housing allowance of the property tax grant (Ontario program for seniors) and the property tax credit (Ontario tax rebate for

[45]The derivation of costs estimates is based on Steele (1985) for 1982 and extrapolated to 1984 using a crude inflator.

renters and homeowners based on income). This allocation would lower costs by approximately 20 percent. See Steele (1985, p. 11)

Steele (1985) compares her estimates for Canada with much higher estimates that have been calculated - for example, Clayton (1981) estimates the cost for Canada for 1984 to be about twice that of Steele's $299 million estimate for 1984. The difference, she argues, results from three different assumptions. First, she assumes a 60 percent participation compared to 100 percent by other authors. Since the evidence for existing Canadian and American programs suggests that take-up is significantly less than 100 percent, even with extensive advertising campaigns, the 60 percent take-up rate seems more reasonable.

Second, Steele's summary of the empirical evidence suggests, as noted above, that the behavioural response to a housing allowance is very small in terms of increased demand for housing and rent inflation. If there were a significant increase in demand with significant rent inflation, subsidy costs would increase because allowance payments are based on rents paid (for those paying less than the threshold rent) and because a greater number of households would become eligible for an allowance.

Third, Steele's estimates assume the allowance will be targetted to the elderly and to families rather than to the entire population. Other authors assume a more comprehensive scheme of allowances.

The cost estimates of Steele and others are based on a number of different parameters - definition of threshold rents, definition of affordability gap, eligibility and so forth. If a government wanted to institute a

housing allowance with lower costs than those presented above, it could easily change any of these variables. Thus the subsidy cost is flexible.

4.2 Additional Expenditures

Housing allowance programs address themselves primarily to the goal of affordability and to a lesser extent, security of tenure. This does not mean that they can adequately replace all other housing programs. For example, public housing (to be discussed below) allows some low income households to obtain housing that they might be unable to obtain in the private rental market, even with a housing allowance subsidy. In terms of availability, public housing is a "shelter of last resort." To the extent that people move into public housing only because of an affordability problem, Steele (1985) argues that housing allowances may result in some reduction in the need for public housing.

Another problem that is only somewhat alleviated by housing allowances results from "unconscionable" rent increases. For a household whose rent increases dramatically in one year over the threshold rent level, the housing allowance will provide little compensation. Thus, some other policy may be required to curtail "unconscionable" rent increases.

Given the lack of behavioural response to housing allowances described earlier, it is expected that no supply programs would be required in response to housing allowances.

5.0 COMPARABILITY WITH RENT REVIEW ESTIMATES

It is very difficult to compare the costs of rent review and the costs of housing allowances because the benefits are not the same. Rent review appears to provide less benefits to low-income groups (see Slack and Amborski (1984)) than does a housing allowance. Since a housing allowance can be much more targetted to particular households (eg. the elderly, families) and because it is based on income as well as rent payments, it can provide relatively greater benefits to those with greatest needs. Also, targetting allows the costs to be much less than they would be for a program to all renters.

The nature of the costs of rent review and of housing allowances is also different: the most significant costs of a housing allowance is the direct subsidy paid by the government. The costs of rent review, though significant to government in terms of foregone tax revenues, are probably more significant in terms of the impact on the housing market than are housing allowances. Many of these costs are difficult to measure, however.

Finally, it should be noted again that estimates for an Ontario housing allowance program relate to a potential (not an actual) program for Ontario for 1984. The true costs of such a program depend on how the government designs the formula and what parameters it chooses.

Table 5

Summary of Costs of a Potential Housing Allowance

Ontario, 1984

	($ million)
Economic Costs	
Effects on housing demand and rents	negligible
Effects on supply of rental housing	-
Compliance costs (excludes information costs)	1.1
Lobbying costs	no estimates available
Administrative costs	$3.98
Transfers	
Redistributive cost	(see subsidy cost below)
Direct subsidy cost	$44 - $54
Additional expenditures	?

6.0 SUMMARY

A number of points can be made with respect to the costs of shelter allowances. First, few authors have considered many costs other than the direct subsidy costs and the administrative costs. These latter costs are by far the largest. Second, as with rent review, housing allowances incur relatively greater transfer (as opposed to economic) costs because they redistribute via the tax system to low-income households. The economic costs are fairly minor. With rent review, however, the economic costs are still somewhat significant.

Finally, one cannot compare the costs of two programs without also comparing the benefits. The benefits of housing allowances appear to be targetted much more directly to low-income households than the benefits of rent review. Also, as noted already, these programs are not necessarily substitutes for one another.

Chapter 4: COSTS OF PUBLIC HOUSING

1.0 WHAT IS PUBLIC HOUSING?

Public (or social) housing has traditionally been defined as rental housing that is owned and supplied by government. It is designed to provide financial assistance for the development of housing projects for low-income families and individuals. Under current arrangements in Canada, public housing is provided by all three levels of government. Tenants in public housing pay on a rent-geared-to-income basis and are chosen on the basis of a point system.

Until the late 1970's there were two forms of assistance for public housing: Long Term Loans and Federal-Provincial Partnership Arrangments.[46] Under Long Term Loans, public housing projects initiated by a municipality and approved by OHC would receive loans from the federal government (90 percent) and provincial governments (10 percent) for capital costs. Operating subsidies were funded by all three levels of government - federal (50 percent), provincial (42.5 percent) and municipal (7.5 percent). Between 1964 and 1981, 90,309 public housing units were provided in Ontario under this program.

Public housing under the Federal-Provincial Partnership Arrangements is a joint undertaking with some possible municipal participation. Capital costs were provided by the federal (75 percent) and provincial (25 percent) governments with municipal involvement reducing the provincial share.

[46]The remainder of this description of public housing relies largely on summaries provided by Pearl Ing of the Commission staff.

Operating deficits were shared in the same manner. Between 1961 and 1966, 5,364 public housing units were provided in Ontario under this program.[47]

Some modifications were made to the public housing program in the late 1970's. Now, there are two programs: municipally-sponsored public housing and provincially-sponsored public housing. In both cases, families and seniors are included and up to 100 percent of tenants pay on a rent-geared-to-income basis.

Under the municipally-sponsored program, a municipal housing corporation may obtain mortgage financing up to 100 percent of the cost of a building. The loans are arranged from NHA-approved private lending institutions. Under the provincially-sponsored program, the Ontario Housing Corporation can obtain loans as with the municipally-sponsored program.

In 1978, under S. 56.1 of the National Housing Act, the Non-Profit and Cooperative Program was implemented to provide assistance to privately-owned non-profit housing corporations to help them develop low cost rental housing and to increase the supply of housing available to low income families, seniors and special groups. There were also programs to encourage and assist in the development of cooperative housing by providing loans plus assistance to municipally-owned non-profit housing corporations. These programs have virtually replaced public housing in this country. To the extent that rent-geared-to-income units are part of these programs, they are clearly a form of public housing. The remaining units are

[47]Ministry of Housing, Community Housing Information System (1985) Socially-Assisted Housing (various years).

generally made available at "low end of market" and receive a subsidy in the form of greatly reduced mortgage rates.

In Ontario between 1978 and 1984, 15,179 units were provided under the Private Non-Profit Housing Corporation Assistance Program, 9,179 units under the Non-Profit Cooperative Housing Assistance Program and 7,341 units under the Municipal Non-Profit Housing Program.[48]

Under the Private Non-Profit Housing Corporation Assistance Program and the Non-Profit Cooperative Housing Assistance Program, assistance is provided in three areas: start-up funds to prepare applications for funding; loans for up to 100 percent of project costs and annual assistance to offset operating losses. Under the Municipal Non-Profit Housing Program, municipalities can receive two types of assistance: capital assistance in the form of NHA insurance on mortgages from NHA-approved lending institutions and operating assistance in the form of an annual federal rent reduction grant to offset operating losses. Provincial assistance is in the form a rent reduction grant, if required. In structures for families, up to 35 percent of units may be allocated to tenants who pay on a rent-geared-to-income basis. In structures for seniors, up to 50 percent are allocated on a rent-geared-to-income basis.

[48]All information provided by Pearl Ing (1985) who derived estimates from Ministry of Housing, Community Information System, 1985. Socially-Assisted Housing 1977-1984.

2.0 ECONOMIC COSTS

2.1 Effects on Demand

Public housing is an in-kind transfer to individuals - transfers are in the form of specific housing services in specific locations. Economists would argue that households would generally prefer a cash to an in-kind transfer since with the former they can choose the type of housing that they want plus they can make their own tradeoffs between housing and other goods and services. Thus, households tend to value public housing at less that its market value (depending on the extent of selection of public housing units). The benefits of public housing are somewhat reduced by this efficiency cost.

Inefficiencies are created because households may continue to live in housing that is no longer appropriate for them when their circumstances have changed. This housing may be more highly valued by other households who cannot obtain units in a public housing project. Thus, there is an efficiency cost. A further cost may result if occupants of public housing are constrained in their employment opportunities because of location. This would result in inefficiencies in the labour market. None of these efficiency costs can be easily measured; no attempts have been made in the literature to quantify these costs.

2.2 Effects on Supply

The effect of public housing on the market for rental housing depends on how much private sector housing is displaced by the provision of public housing. This is known as the "displacement effect." Chant (1985) argues

that if the supply of rental housing is elastic (i.e. very responsive to price changes), then the provision of public housing could reduce the supply of private housing (by lowering rents). Even in the short run, private suppliers may reduce the supply of new units in anticipation of public housing programs. Muller (1985) analyzes the impact of public housing on private supply where new housing is constructed and where public housing is directly provided from the existing stock. He concludes, based on a theoretical analysis (Muller (1985), pp. 254-263), that public housing where new units are supplied does displace private sector supply. The displacement increases over time but never completely offsets the increment to the housing stock.[49] As Muller (1985, 274) points out, increasing subsidies would be required as public housing displaced the existing stock.

Chant, in his testimony before the Commission of Inquiry into Residential Tenancies, calculated the magnitude of the displacement effect. For 110,000 units, the net addition is estimated to be between 29,000 and 45,000 units depending on the supply elasticity used. This net addition means that the displacement effect is between 65 percent and 81 percent of the number of public housing units.

Another aspect of supply that is stressed in the literature is the differential cost between public supply of rental units and private supply. The results indicate that public housing is more expensive than are rent subsidies for providing adequate low-income housing. It is this

[49]Where existing housing is purchased to provide public housing, it can increase the total supply of housing services.

differential that represents an economic cost since these resources could have been used more efficiently. The actual outlay of the government for public housing represents a transfer to low-income households as will be noted below. However, the amount over and above what it would have cost the private sector to provide the same housing is an economic cost.

Chant (1985) modifies slightly the estimates of Marks (1984) showing the difference between public housing costs and a rent supplement for Ontario for 1983. The rental cost of public housing (which approximates the rent which would be paid on behalf of households who could not afford to pay any rent) is calculated at $554 to $564 per month or $628 to $640 depending on how units are compared inside and outside of Metropolitan Toronto. These rental costs of public housing can be compared with a 3-bedroom unit in Toronto - $478 (controlled) and $584 (uncontrolled) or a 2-bedroom unit in Toronto - $401 (controlled) and $518 (uncontrolled).

A less sophisticated study by MacMillan and Nickel, cited in Chant (1985), estimated the costs of public housing to be 60 percent higher than the costs of housing families in private accommodation with a full rent subsidy. The results are not particularly reliable because of the assumption underlying the analysis. See Chant (1985).

Data from CMHC (1983, 126) as cited in Muller (1985) shows that construction costs of apartments in 1979 in Ontario under S.56.1 were 19 percent greater than those apartments insured under S.6 of the NHA. In 1980, they were 53 percent higher. Although these data appear to indicate that publicly provided housing is more expensive than privately-provided housing, the estimates are inconclusive since different types of apartments

are being compared. Chant (1985) does suggest, however, that public production seems to be more costly than private production.

2.3 Information, Search and Transaction Costs

Costs will be incurred by tenants in trying to find public housing units, determining eligibility, satisfying requirements for eligibility and then waiting in line for an available unit. No estimates of these costs have been made but one can assume that these are largely time costs and can be measured by the opportunity cost of the potential occupants' time.

2.4 Cost of Rent-seeking

As with shelter allowances, no rent-seeking costs have been estimated for public housing. Some tenant groups and Social Planning Councils, however, would be expected to direct some funds to lobbying for the continuation of public housing.

2.5 Direct Administrative Costs

Costs are incurred by the public authority to determine eligibility for public housing by assessing applicants according to various criteria and by determining priorities. Applicants would have to be notified of available space and their status regularly monitored to determine the amount of subsidy for which they are eligible. There is also, of course, the more significant operating costs to consider.

Woods Gordon (as cited in Chant (1985)), estimated the direct operating costs of the Community Housing Division of the Ministry of Housing per unit of housing produced in 1980 to be $825 (excluding the work of appraisers and other Ministry of Housing staff outside of the Division). They also report that CMHC's administrative cost for each unit financed or supplied averaged $678 per unit in 1980.

Chant (1985) suggests that, since public housing would likely incur both the direct operating costs and administrative costs, an amount of $1500 should be added to the overall cost of each unit in 1980.

3.0 TRANSFERS

As with housing allowances, it can be noted that public housing provides a transfer (in-kind in the case of public housing) to low-income individuals and families that is financed by government general revenues. The total impact of this program, then, should consider the effects of how it is financed.

4.0 COSTS TO GOVERNMENT

4.1 Direct Outlay

The direct outlay for public housing in Ontario includes capital and operating expenditures of all three levels of government. These amounts for 1983-84 for Ontario are:

	Public Housing[50]	S.56.1[51]
	($ thousands)	
federal government	156,687	$111,000
provincial government	133,184	$ 9,000
municipal government	23,503	---
Total	$313,374	$120,000

These amounts also include administrative costs. The amount for public housing implicitly includes the higher cost of publicly-supplied as opposed to privately-supplied rental housing, as noted above.

A 1983 CMHC study estimates that the present value of the total subsidy for S.56.1 non-profits and co-ops is approximately $47,000 per unit. It also indicated that the present value of total subsidy costs is highest for rent-geared-to-income units provided under S.56.1 than any other social housing programs of the federal government.

4.2 Additional Expenditures/Tax Expenditures

Public housing is designed to provide housing for low-income families and seniors. As noted previously in the discussion of shelter allowances, it is a "shelter of last resort" providing housing to those who cannot find it in the private market. It cannot, at the same time, achieve other goals of housing policy and thus other programs are still required for other purposes.

[50]These numbers were estimated on the basis of the provincial share of $133,184,903 using the operating expenditure breakdown of 50 percent federal, 42.5 percent provincial and 7.5 percent municipal.

[51]These estimates include the urban and native program which is relatively small.

If it could be shown (and the evidence is inconclusive) that public housing displaces private housing, there might be an argument for the need for programs to stimulate private rental supply. However, the evidence on supply is vague.

5.0 COMPARABILITY WITH RENT REVIEW ESTIMATES

As with housing allowances, it is very difficult to compare the cost of rent review with the costs of public housing, nor, it can be argued, is it an appropriate comparison. Public housing is specifically aimed at providing housing to low-income households. These are households that are unlikely to obtain housing in the private market partly because of affordability problems but also because of discrimination, lack of information and other factors. Even with rent review, there will be households who will not benefit because they cannot obtain a controlled unit. In other words, public housing is not a substitute for rent control.

It might make more sense to compare public housing with a shelter allowance because they have one common objective: to provide housing to low-income families and seniors. The best way to do this would be to take the amount spent on public housing and then try to design a shelter allowance to meet that cost. A comparison could then be done of how each program meets its objectives for a given outlay. It would seem, at the outset, that given the economic costs associated with public housing, housing allowances would provide a more efficient way of delivering benefits to low-income households.

6.0 SUMMARY

The available estimates for public housing are summarized in Table 6. The largest cost is the subsidy which includes, as part of it, the economic costs from having the government provide housing at a higher cost than the private sector. The more recent non-profit housing programs under S. 56.1 of the National Housing Act involve only a subsidy since the government no longer provides the housing. From an efficiency perspective, non-profits would thus involve lower economic costs.

As with housing allowances, it is difficult to compare the costs of public housing with the costs of rent review because the two programs provide different benefits.

Table 6

Summary of Costs of Public Housing, Ontario, 1984

Economic Costs	
Demand costs	no estimates available
Displacement effect	65 to 81 percent of public housing units
Compliance costs	no estimates available
Lobbying costs	no estimates available
Administrative costs	$1500 per unit per year
Differential cost	around $100 per unit per month
Transfers	($ million)
Redistributive costs	?
Direct outlay - public housing	$313.4[1]
- non-profits	120.0
Additional expenditures	?

Note: 1) This amount includes administrative costs and the real resource cost from the more expensive publicly provided housing (differential costs above).

Chapter 5: SUMMARY AND CONCLUSION

This paper has attempted to summarize all of the costs of rent review that appear in the literature and, where possible, to update these numbers for 1984. Cost estimates are also provided for two other housing programs - a housing allowance (a potential program in Ontario) and public housing (an actual program). Costs have been differentiated according to economic costs and transfers.

A comparison of the costs of rent review, housing allowances and public housing suggests that the greatest transfers are incurred by public housing followed by rent review and then housing allowances. For public housing, the largest transfers result from capital and operating expenses. With rent review, the largest transfers result from foregone tax revenues (especially the municipal property tax) and other government expenditures required to stimulate rental supply. For housing allowances, the greatest transfer is the actual subsidy to households.

Both public housing and housing allowances redistribute income from all taxpayers to low-income households. The more progressive is the incidence of general tax revenues (that is, the more it bears on relatively high-income people), the more progressive will be the impact of these programs. Rent review, on the other hand, redistributes income from landlords of controlled units to tenants of controlled units. Previous studies of the distributive cost of rent review have indicated that this is not a progressive redistribution.

With respect to the economic costs, those costs that use up society's resources, a comparison among programs is much more difficult largely because there are no dollar estimates of many of these types of costs. In the case of rent review, economic costs are incurred because of the potential reduction in the supply of rental units and maintenance expenditures, search and queueing costs, compliance costs, lobbying costs and administrative costs. With public housing, inefficiencies arise because people are subsidized to live in particular housing units rather than being given the choice of where to live. There will also be economic costs because, the evidence shows, public housing costs more to provide than privately supplied housing. In addition, there will be displacement costs, search and queueing costs, compliance costs, administrative costs and other costs similar to rent review. Finally, the economic costs for housing allowances arise because of potential increases in the demand for rental housing and rent inflation as well as compliance and administrative costs.

The evidence that exists suggests that economic costs will be lowest for housing allowances largely because they create the least distortion in the marketplace. Since the empirical studies to date show a negligible behavioural response in terms of housing demand and rent inflation, the economic costs are fairly small relative to public housing and rent review.

The distinction between economic costs and transfers is useful in that it gives an idea of what policies affect total output in the economy and what policies just provide transfers from one group in society to another. However, it is sometimes difficult to differentiate between the two types

of costs. Some transfers in the short run, for example, may result in economic costs in the long run. The distinction is not always clear.

From a policy perspective, transfers are as "real" as are economic costs. One cannot say that redistribution from landlords to tenants is not important because it does not use up any resources. It is very important to the parties affected. Thus, the distinction between economic costs and transfers is important in economics, but it may not be as important in a policy-making context.

The actual estimates provided in this paper are very tentative. As noted throughout, there is no consensus in the literature on the impact of rent review on specific variables such as rents and rental starts. Also, as noted previously, many of the economic costs are not quantifiable. The numbers that are provided are only crude estimates based on several assumptions.

Even if all of the estimates were reliable, there are still problems in trying to compare costs of different housing programs. Housing allowances, for example, address the affordability problem of low-income people. Rent review does not necessarily benefit low-income people. Public housing provides housing directly to low-income families. The objectives are different; the nature of the benefits are different; the beneficiaries are different. Furthermore, all three programs may be required simultaneously. It is not enough to compare the costs. One also has to look at how well each program meets its intended objectives.

Appendix[52]

Calculation of Net Income Tax Loss per Dollar of Reduced Rental Income

1. **Tax revenue on the marginal dollar received by landlord**

   (a) Landlord receives: $1

   (b) Tax paid by landlord: t' (1)

   (c) Marginal revenue of landlord's suppliers:

   $(1-t')(1-m')$

   (d) Tax paid by landlord's suppliers:

   $(1-t')(1-m')t$ (2)

   (e) Marginal revenue next round:

   $(1-t')(1-m')(1-t)(1-m)$

   (f) Tax paid next round:

   $(1-t')(1-m')(1-t)(1-m)t$ (3)

Generalizing

Marginal revenue will be of the form:

$$(1-t')(1-m')(1-t)^n(1-m)^n$$

Tax will be of the form:

$$(1-t')(1-m')(1-t)^n(1-m)^n t$$

Hence, summation of the tax series is:

$$T_L = t' + (1-t')(1-m')t \sum_{n=0}^{\infty} (1-t)^n(1-m)^n \quad (4)$$

where

t is effective tax rate on gross income for the economy generally

m is leakages for imports and savings for the economy generally

t', m' are corresponding rates for landlords

m'' is corresponding leakage for tenants

[52]This appendix was prepared with the assistance of John Todd.

2. <u>Tax revenue on the marginal dollar saved by the tenant (rent reduced by controls)</u>

(a) Tenant taxes unaffected

(b) Marginal revenue of suppliers of goods and services to tenants:

$(1-m")$

(c) Tax paid by suppliers:

$(1-m")t$ (1a)

(d) Marginal revenue subsequent round:

$(1-m") (1-t) (1-m)$

(e) Tax paid subsequent round:

$(1-m") (1-t) (1-m)t$ (2a)

(f) Marginal revenue next round:

$(1-m") (1-t)^2 (1-m)^2$

(g) Tax paid next round:

$(1-m") (1-t)^2 (1-m)^2 t$ (3a)

Generalizing

Marginal revenue will be of the form:

$$(1-m") (1-t)^n (1-m)^n$$

Tax will be of the form:

$$(1-m") (1-t)^n (1-m)^n t$$

Hence, summation of the tax series is:

$$T_T = (1-m")t + (1-m")t \sum_{n=1}^{\infty} (1-t)^n (1-m)^n$$

$$= (1-m") [t + (1-t) (1-m)t \sum_{n=0}^{\infty} (1-t)^n (1-m)^n] \quad (4a)$$

3. Net income tax effect per dollar of reduced rental income

Subtracting the two tax series, (4) - (4a) gives:

$$T_L - T_T = [t' - (1-m")t] + [(1-t')(1-m') - (1-m")(1-t)(1-m)]\, tS$$

where

$$S = \sum_{n=0}^{\infty} (1-t-m-tm)^n$$

$$= \frac{1}{t+m+tm}$$

4. Estimates based on alternative assumptions

(a) i) Assumptions:

$t = (0.3)(0.35) = .12$

$m = m' = m" = 0.1 + (0.9)(.25) = .325$

$t' = (0.95)(0.35) = 0.335$

ii) Estimate:

$$T_L - T_T = [0.335 - (0.675)(0.12)] + [(0.665)(0.675) - (0.675)^2 (0.88)]\ (0.12)\ [1/(.12 + .325 + .039)]$$

$$= 0.27$$

(b) i) Assumptions:

$t = (0.3)(0.35) + .1 = .22$

$m = m' = m" = .25$

$t' = (0.95)(0.35) = 0.335$

ii) Estimate:

$$T_L - T_T = [0.335 - (0.75)(0.22)] + [(0.665)(.75) - (0.75)^2 (0.78)]\ (0.22)\ [(1/(.12 + .325 + .039)]$$

$$= 0.20$$

5. Calculation of Offset

Assume marginal tax rate = .35

offset = x

(a) $.35 - x(.35) = .20$

$x = .43$

therefore offset is 43 percent

(b) $.35 - x(.35) = .27$

$x = .23$

therefore offset is 23 percent

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